

Realty Stock Review

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Market Strategy: Three Events May End Realty Stock Slide

We think odds are better than 50-50 that the 39-month bear market in realty stocks ended during the week of May 11.

Like every market call, we believe this potential turn must be validated by subsequent events that would include sharply lower interest rates, some real progress on stanching the Federal budget hemorrhage, and a rebound in economic growth to start absorbing overbuilding in most local markets.

But if you believe, as we do, that most market trends start in Washington, then last week's momentous events in the nation's capital could serve to ignite a significant market rally that could spill over into the battered realty stocks. Those events included:

—No-Conditions Budget Talks. President Bush told Congressional leaders he was willing to begin negotiations over closing the budget gap "without preconditions." The phrase immediately sparked wave after wave of speculation about whether the President had abandoned his "no new taxes" pledge of the 1988 campaign, and his closest aides said he reserved the right to disapprove of any tax increases. Democrats fear the President means to saddle them with the onus for being the first to favor higher taxes.

The President has clearly moved Washington's ongoing budget debate off dead center, and the markets smell progress that could ease pressure on money markets. How all this may play out inside Washington's Beltway isn't clear and bears close watching, but stock markets are acting as if the budget deficit already is on the way of the buggywhip. President Bush's move to negotiate marks a clear change in direction and strategy, a redirection we doubt the President will not abandon lightly and then only if and when budget talks

prove fruitless. The message: the market likely will act for some time as if the budget deficit is on the way to being cured. One tangible result: Market yields on the widely watched 30-year Treasury bonds fell 0.5% in little over two days and the smell of cheaper money ignited the stock and bond markets. We don't expect miracles but think the corner leading to lower interest rates has been turned.

—Common Sense in Bank Lending. Federal Reserve Chairman Alan Greenspan, Comptroller of the Currency Robert Clarke and FDIC Director William Seidman met May 10 to urge leaders of the American Bankers Assn. not to curb lending in response to tighter supervision (see RSR, Mar. 23 and April 27). The meeting was called ostensibly to demonstrate solidarity in banking regulation by the industry's three major regulatory agencies but the Fed clearly wanted to get across a broader message to bankers: Don't throw the country into a recession by reacting too sharply to tougher rule enforcement by bank examiners.

The meeting echoes for us the famous February 3, 1975 meeting in which officers of the Nat. Assn. of REITs urged CEO's of the nation's largest banks to stand calm in wake of the first large REIT bankruptcy of that era. Bankers became

less strident after that and realty stocks began a three-year bull market largely as a result of the ensuing calmer REIT-bank negotiations.

Such pow-wows generally don't solve anything but tend to calm fears and speculation of worst-case scenarios. Clearly credit will continue to be tight for new real estate construction, as it should be. But the May 10 meeting should temper the more outrageous suggestions that all real estate borrowers will go begging.

—Realism on Selling S&L Foreclosures. The Resolution Trust Corp., responsible for selling approx. \$18 bil. of foreclosed real estate piling up in seized savings and loan associations, began paving the way for price cuts up to 30% for slower-moving properties. Since RTC began operating last summer, its take-it-or-leave-it pricing tactics have failed to attract significant buyers — only about \$2 bil. worth of properties has been sold — and have left RTC way behind schedule in moving properties back into private ownership. RTC plans some massive property auctions this summer and needs pricing flexibility to get properties moving. About 70% of foreclosures are in the Southwest, where realty markets have been recovering slowly from the mid-1980s recession.

Taken as a whole, these three events

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dramatically alter the climate for real estate stocks. Be cautioned that nearly all our technical measures show that real estate stocks remain mired in a bear market (see Market Pulse, p. 4), but that's to be expected given the unprecedented length of the 1987-1990 bear market.

The climate is changing just as a new generation of spinoffs and rescue rollups are poised to reach public stock markets. We have the strong feeling that the combination of fresh new merchandise and a calmer atmosphere in Washington may reverse this bear market in realty stocks.

Market Climate: New Realty Stocks May Rekindle Interest

Could a new generation of realty stocks play Moses to lead today's realty stocks out of their bear market bondage?

We think that prospect is better than even money. Some major-league real estate companies are prepping to come public, even as the current generation of realty stocks remains mired in their longest bear market on record (see RSR, April 27).

This new generation of realty stocks will come from two disparate sources: Spinoffs of realty divisions of major industrial corporations, and rollups of major limited partnerships after their properties are marked to today's market.

To get ready for this major event of 1990 and beyond, we plan reviewing these new stocks near the time they go public during this year. Announced candidates so far are:

—**Santa Fe Pacific Realty**, the proposed spinoff of real estate now 80% owned by Santa Fe Pacific Corp., the railroad holding company.

—**Marathon Realty**, the proposed spinoff of the real estate company of Canadian Pacific Ltd., the Canadian railway giant. About 41% of Marathon's \$2.2 bil. (Canadian) realty assets are located in the U.S.

—**Hallwood Realty Partners L.P.**, a proposed rollup of 11 real estate limited partnerships initially sponsored by Equitec Financial Corp., a troubled realty syndicator and mutual fund manager.

—**Castle & Cooke Inc.**, which plans to spin off its Dole Food Co. Inc. unit this year and operate solely as a major landowner and developer in Hawaii.

Most will require complex and lengthy approvals by interested persons (corporate shareholders and/or limited partners), meaning these stocks may not begin trading until late this year. Despite this delay, there may be arbitrage opportunities which can be exploited before final approvals are given, although we generally are not big fans of this type of arbitrage. We review here Marathon Realty, the most imminent of the spinoffs. Being a

Canadian company, Marathon also typifies both the risks and rewards when U.S. investors go outside U.S. boundaries for stock purchases.

Marathon Realty Co. Ltd.: Unknown Canadian Giant

Marathon Realty, one of Canada's largest investment builders, will be spun off about May 24 from Canadian Pacific (CP: NYSE), Canada's railroad giant. Holders of CP will receive one-fourth Marathon share for each CP share held, which will result in Marathon beginning life with 99.4 mil. shares outstanding.

We think Marathon has four major positive points of interest and one major negative risk for consideration by U. S. investors (all values in this review are in U.S. dollar equivalents):

1. Offshore Strategy: One of the hottest strategies going in real estate is that of investing outside the U.S. to mitigate the impact of the U.S. realty recession. Marathon fits neatly into such a strategy. Having said that, many conservative investors view offshore investing as an aggressive strategy because foreign stock markets and companies don't play by the same disclosure rules as U.S. companies. But the world of real estate is rapidly globalizing, just as are many other facets of international capital markets. Lest you get carried away by the concept of offshore investing, be advised that most foreign real estate markets are also laboring with overbuilding, although none that we know of is so overburdened with surpluses in nearly all product types and locations.

Marathon makes sense as part of an offshore strategy because we see Canadian capital markets as most nearly compatible with those of the U.S. in terms of disclosure, corporate governance, and investment style. But Marathon shares initially will trade only on the Toronto exchange and the company has no present plans to list its shares on any U.S. exchange including NASDAQ, which may limit interest by U.S. investors.

2. Open-door Investments. The long-standing deficiency of many Canadian real estate companies — and indeed real estate

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companies in many other countries as well — is that they are controlled by major investors or other corporations. Public investors in effect are riding as minority partners with these major interests. Canada's two largest real estate companies, **Trizec Corp. Ltd.** (TSE: TZC US\$16.75) and **Bramalea Ltd.** (TSE: BCD US\$12.33) — are both controlled about 74% and 67% respectively by the Bronfman family, which made its fortune in the Seagram's distillery business. Thus the float of stock available for public purchase in both companies is relatively small and trading is accordingly thin.

Marathon breaks with this closed-door tradition because its stock will be 80% owned by public investors, while Canadian Pacific retains 20% of its shares. During its over two decades as a CP subsidiary, Marathon has developed a seasoned institutional management which exercised a great deal of independence inside CP (Marathon for years published its own annual report, for instance). Thus we see Marathon as a more inviting company for public shareholders.

3. Economies of Scale. Canada grows its realty companies big — really big. Marathon for instance owns US\$1.93 bil. realty assets which makes it roughly four-fifths the size of Rouse Co., far and away the largest publicly owned U.S. real estate developer. Still Marathon is only about one-fourth the size of US\$8.75 bil.-asset Trizec and less than half the size of US\$4.8 bil.-asset Bramalea.

Canadian realty companies seem to grow because they can borrow on an unsecured basis from a small number of large Canadian banks which operate nationally, and because the large distances between population centers in Canada seems to encourage managers to learn how to run large diversified operations. Large size translates into staying power to weather market downturns and insulation from catastrophic harm should one or more individual buildings miss its market or encounter slow leasing.

4. Big U.S. Presence. While the Canadian realty giants are Canadian in origin and financing, they have become major players in U.S. real estate markets. This occurs because investment opportunities tend to become limited in a country about one-tenth the size of the U.S. in population.

In this tradition Marathon holds 41% of its US\$1.86 bil. assets in U.S. properties, or a U.S. investment portfolio of US\$768 mil. Bramalea carries a slightly lower 32% of its US\$4.5 bil. assets at cost in the U.S. Trizec has an even greater U.S. presence through 100% ownership of West Coast shopping center developer Ernest W. Hahn Co. and 23% ownership of Rouse Co.

5. Cross-Currency Risks. There's always a danger that an offshore investment will do very well in terms of its own currency but will suffer when that currency is translated into U.S. dollars. U.S. investors always have to try and control this cross-currency risk.

The best investment players aim to invest in currencies that are strong relative to the dollar. When the foreign currency weakens, they then try to move back into dollars. Making these switches accurately requires both a knowledge of currency market trends as well as the underlying business of the stock investment. The Canadian dollar began a long slide in the late 1970s, falling below 75-cents per U.S. dollar at its low before rebounding. Right now the Canadian dollar trades at 0.858-cents per U.S. dollar, or about a 15% discount. We have converted Canadian dollars into U.S. dollar equivalents in this review of Marathon, to avoid any confusion for our U.S. investor subscribers.

In today's overbuilt markets, the Canadian biggies have to hustle for leases just like every U.S. realty project, so U.S. exposure translates into a slight negative in the current environment. But Canadian developers have protected themselves by building larger trophy properties which have fared somewhat better in leasing and in price during the downturn. Trizec's relations with Rouse and its ownership of Hahn typify this quest for top-of-the-line product. When the U.S. market turns, we expect this bigger U.S. presence to become a positive for the Canadians.

Operations and Asset Value. Marathon has developed or holds venture interests in a diversified portfolio of highly visible, trophy type income properties, most of which it has developed. Here's a snapshot look at Marathon's net property interests after depreciation, by property type and location by square footage and investment in U.S. dollars:

	Canada	United States	Totals	Net Invest.
	Mil. Sq.Ft.	Mil. Sq. Ft.	Mil. Sq. Ft.	Mil. \$
Office Buildings	8.16M	1.92M	10.08M	\$840
Shopping Centers	5.56M	3.98M	9.54M	770
Industrial & aviation	2.34M	—	2.34M	NA
TOTALS	16.06M	5.90M	21.96M	

Dollar invest. US\$1,092M US\$768M US\$1,860M

By comparison, major U.S. investment builders such as Rouse and Forest City Enterprises have net ownership interests ranging from 10 to 15 mil. sq. ft. By that measuring rod, Marathon is big league indeed. The numbers cited above show that Marathon's net cost for properties is about \$83/SF for offices and \$81/SF for shopping centers, numbers that are significantly below today's construction costs.

Better, Marathon is making money on its overall holdings. It earned \$80.8 mil. or 82¢/sh. pro forma for 1989, with about one-third coming from its large land holdings. Offices are 92%-93% occupied in both Canada and the U.S. Canadian shopping centers are 93% occupied but U.S. centers, mainly Texas, are only 80% occupied. Land holdings, including key downtown parcels in Toronto and Vancouver, are crucial to Marathon's future. It estimates current value of existing and under-construction properties at \$833 mil. over cost, giving Marathon about \$10.75/sh., current value. We'll follow Marathon as it operates publicly.

MARKET PULSE: Possible Credit Ease Buys Realty Stocks

A drop in interest rates again appears to be the major dynamic behind price movements in the realty stock universe. Realty stocks posted their best high/low showing in seven months during the May 11 week. The force behind this strength was an indication from both the White House and the Federal Reserve Board that lenders had become overly selective and that credit should not be tightened (see p. 1).

High/low Indicator: While last week's strength should not yet be considered a reversal of the secularly negative price trend, weaknesses could conceivably be bottoming. In the week ended May 11, five realty stocks touched new 52-week highs and realty stocks, the highest number of New Highs since last Oct. 13. New Lows also rose to 28, leaving our Net High/Low indicator at negative 23 reading, little changed. Our tally:

Week	New Highs	New Lows	Net	-% of All Stocks	Highs	Lows
May 11	5	28	-23	1.2%	5.3%	
May 4	0	23	-23	0.0	3.3	
Apr.27	0	22	-22	0.0	2.7	
Apr.20	2	29	-27	0.7	4.6	
Apr.12	1	23	-22	0.4	4.6	
Apr. 6	2	18	-16	0.6	3.0	
Mar.30	1	20	-19	0.3	4.3	
Mar.23	1	22	-20	0.3	4.7	
Mar.16	2	22	-20	0.6	5.7	
Mar. 9	3	13	-10	0.9	3.6	
Mar. 2	3	14	-11	1.2	2.5	

NEW HIGHS: The five realty stocks hitting new highs include two mobile home makers, Clayton Homes and Oakwood Homes; one diversified homebuilder Centex Corp. and one small builder, Christiana Companies; and a specialized REIT, Wetterau Properties.

Centex Corp. (CTX:NYSE), the giant Texas-based developer and building materials supplier and a Portfolio Planner stock, has kept EPS momentum during a tough environment and we expect gains in its March 1991 year (RSR, April 27).

Christiana Companies (CST:NYSE), a diversified company with real estate operations, posted new highs just before news of an \$8.1 mil. verdict against

a homebuilding subsidiary was announced. The stock retreated 3/8 on the news. While large, the damages are partly covered by insurance and existence of the suit has effectively crimped Christiana's plans and operations in recent years.

Clayton Homes, Inc. (CMH:NYSE), Tennessee based mobile home maker and retailer, reported a 20% EPS gain to 25¢/sh. in the March quarter; for the nine months to March, revenues rose 6% to \$179.1 mil. and earnings jumped 14% to 67¢/sh. About half of Clayton's growth came from a 42% increase in its mobile home loan servicing portfolio to \$394 mil.

Oakwood Homes (OH:NYSE), a Greensboro, N.C. maker and marketer of mobile homes, posted a five-fold EPS gain in the March qtr. to 25¢/sh. on a 62% sales surge. Six months results were similarly impressive and OH looks like it could earn in the 75¢-\$1 range for its Sept. 1990 fiscal year, up from 54¢ in fiscal 1989. OH thus continues an impressive comeback from depressed 1987 and 1988 when it earned only 7¢ and 8¢/sh. respectively.

Wetterau Properties, Inc. (WTPR:OTC), an equity REIT which recently moved into net leased retail properties, posted a 45% increase in earnings in 1989 and a 20% increase in EPS to 59¢/sh. on a higher number of shares outstanding. WTPR, which isn't covered regularly in RSR because of its thin float, originated as a REIT owning warehouses net leased to its sponsor Wetterau Inc., a major national food wholesaler. WTPR paid 50¢ dividend last year and sells to yield 3.8%.

NEW LOWS: A total 38 realty stocks made at least one new 52-week low during the two weeks ended May 11. Groups containing new lows placed by order of magnitude held their relative positions. By loosely based groups and number of new lows in each:

Equity REITs/Property Owners - 13: Burnham Pacific Properties, Chicago Dock & Canal Trust, Dial REIT, EQK Realty Investors, Eastgroup Properties, Medical

Properties, New Plan Realty, One Liberty Properties, Prudential Realty Trust income shares, USP REIT, United Dominion Realty Trust, Universal Health Realty Income Trust, and Western Invest. RET.

Burnham Pacific, Dial, New Plan, United Dominion and Western appear to be bargains as they cover dividends. Burnham Pacific's first quarter was slow, result of slow retail leasing. Dial's cash flow was flat but no concern; Dial lists May 18 on the NYSE under DR symbol. New Plan stock dived when a large tenant, Ames Dept. Stores, filed Chapter XI but recovered on prospects for releasing any vacancies quickly; NPR expanded to southern Georgia by buying 11 shopping centers with 800,000 sq. ft. Western IRET boosted payout 1.4% to \$1.44 annual rate.

Investment Builders/Property Owners - 2: Forest City A, Rouse Co.

Homebuilders - 8: Leisure Tech. preferred, Lennar Corp., NVR L.P., Oriole Homes A & B, J.M. Peters Co., Standard Pacific, L.P., UDC-Universal Development L.P. Soft first quarter results and falling margins have hurt Western builders such as J.M. Peters, Standard Pacific and UDC-Universal. Lennar and Oriole are impacted by weak Fla. markets, while soft NJ markets are hurting Leisure Tech.

Land Developers - 3: Deltona Corp., General Development Group, Punta Gorda Isles.

Investment/leaseback MLPs - 2: Prime Motor Inns, L.P., Red Lion Inns, L.P.

Mortgage lenders - 5: American Realty Trust, Angeles Participating Mortgage Trust, Cenvill Investors, Lomas & Nettleton Mortgage, Mortgage Investments Plus. American Realty on April 5 cut payout 48% to 80¢ annual rate. Lomas & Nettleton Mortgage paid 21¢ quarterly on May 14 and then said it would review status in August. LOM met a crucial deadline by repaying \$177.3 mil. bank debt on April 30. Cenvill opted on May 8 to pay a 5% stock dividend to recordholders June 1 in lieu of cash payout. Many lenders have been plagued by bad loans and diminishing spreads.

Liquidating - 3: Americana Hotel, Hotel Investors, MONY REI.

Syndicators - 2: Angeles Corp. common and units.